

REPORT OF INDEPENDENT PUBLIC ACCOUNTANTS MISSOURI STATE LIBRARY

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To the Missouri Lottery Commission:

We have audited the accompanying balance sheets of the Missouri Lottery and the Missouri Lottery Grand Prize Winners Trust Account as of June 30, 1996 and 1995, and the related statements of revenues, expenditures and retained earnings, cash flows and changes in grand prize winners trust account for the years then ended. These financial statements are the responsibility of the Lottery's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with generally accepted auditing standards. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the Missouri Lottery and the Missouri Lottery Grand Prize Winners Trust Account as of June 30, 1996 and 1995, and the results of operations, cash flows and changes in grand prize winners trust account for the years then ended in conformity with generally accepted accounting principles.

Arthur Andersen LLP

St. Louis, Missouri,
October 11, 1996

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MISSOURI LOTTERY

BALANCE SHEETS AS OF JUNE 30, 1996 AND 1995

| | <u>1996</u> | <u>1995</u> |
|--|----------------------|----------------------|
| <u>ASSETS</u> | | |
| CURRENT ASSETS: | | |
| Cash and cash equivalents | \$ 19,946,523 | \$ 20,074,302 |
| Accounts receivable | 15,752,240 | 13,929,623 |
| Ticket inventories | 132,065 | 400,459 |
| Other | - | 337,639 |
| | <u>35,830,828</u> | <u>34,742,023</u> |
| Total current assets | | |
| PROPERTY AND EQUIPMENT | 7,144,907 | 7,624,634 |
| | <u>\$ 42,975,735</u> | <u>\$ 42,366,657</u> |
| Total assets | <u>=====</u> | <u>=====</u> |
| | | |
| <u>LIABILITIES AND RETAINED EARNINGS</u> | | |
| CURRENT LIABILITIES: | | |
| Accounts payable | \$ 5,356,852 | \$ 4,624,712 |
| Due to Lottery Proceeds Fund | 3,856,322 | 8,540,639 |
| Accrued prize liabilities | 26,934,066 | 22,296,963 |
| Other accrued liabilities | 1,294,778 | 953,383 |
| Capital lease obligations | - | 848,419 |
| | <u>37,442,018</u> | <u>37,264,116</u> |
| Total current liabilities | | |
| OTHER DEFERRED LIABILITIES | 5,533,717 | 5,102,541 |
| RETAINED EARNINGS | - | - |
| | <u>\$ 42,975,735</u> | <u>\$ 42,366,657</u> |
| Total liabilities and retained earnings | <u>=====</u> | <u>=====</u> |

The accompanying notes are an integral part of these balance sheets.

MISSOURI LOTTERY

STATEMENTS OF REVENUES, EXPENDITURES AND RETAINED EARNINGS

FOR THE YEARS ENDED JUNE 30, 1996 AND 1995

| | <u>1996</u> | <u>1995</u> |
|--|--------------------|--------------------|
| OPERATING REVENUES: | | |
| On-line ticket sales | \$ 194,204,706 | \$ 200,236,051 |
| Instant ticket sales | 198,735,269 | 183,790,370 |
| Pull-tab ticket sales | 29,590,970 | 27,638,403 |
| | <u>422,530,945</u> | <u>411,664,824</u> |
| Total operating revenues | | |
| OPERATING EXPENDITURES: | | |
| On-line prize expense | 98,676,688 | 101,384,178 |
| Instant prize expense | 112,089,536 | 102,974,196 |
| Pull-tab prize expense | 18,754,308 | 17,392,488 |
| On-line retailer commissions and incentives | 11,085,507 | 10,613,929 |
| Instant retailer commissions and incentives | 12,968,376 | 11,813,339 |
| Pull-tab retailer commissions and incentives | 2,397,278 | 2,242,438 |
| Cost of tickets sold | 12,556,996 | 12,339,100 |
| Advertising and promotions | 11,264,564 | 10,650,111 |
| Wages and benefits | 6,093,406 | 5,837,321 |
| Other general and administrative | 10,002,209 | 8,087,720 |
| | <u>295,888,868</u> | <u>283,334,820</u> |
| Total operating expenditures | | |
| Operating revenues over expenditures | <u>126,642,077</u> | <u>128,330,004</u> |
| NONOPERATING REVENUES: | | |
| Interest income | 1,124,258 | 937,649 |
| Other | 291,825 | 154,571 |
| | <u>1,416,083</u> | <u>1,092,220</u> |
| Total nonoperating revenues | | |
| Income before transfers | <u>128,058,160</u> | <u>129,422,224</u> |
| TRANSFERS TO STATE OF MISSOURI: | | |
| Operating transfers | (128,058,160) | (129,422,224) |
| | <u>-</u> | <u>-</u> |
| Excess of revenues over expenditures and transfers | | |
| RETAINED EARNINGS AT BEGINNING OF YEAR | <u>-</u> | <u>-</u> |
| RETAINED EARNINGS AT END OF YEAR | <u>\$ -</u> | <u>\$ -</u> |

The accompanying notes are an integral part of these statements.

MISSOURI LOTTERY

STATEMENTS OF CASH FLOWS

FOR THE YEARS ENDED JUNE 30, 1996 AND 1995

| | <u>1996</u> | <u>1995</u> |
|--|----------------------|----------------------|
| CASH FLOWS PROVIDED BY OPERATING ACTIVITIES: | | |
| Income before transfers | \$ 128,058,160 | \$ 129,422,224 |
| Adjustments to reconcile income before transfers to net cash provided by operating activities- | | |
| Operating transfers | (132,311,303) | (125,169,977) |
| Depreciation | 2,255,563 | 2,085,361 |
| Gain on sale of assets | (152,893) | (90,083) |
| Grand prizes deferred | 7,579,018 | 14,734,329 |
| Transfers to Grand Prize Winners Trust Account | (7,579,018) | (14,734,329) |
| Change in assets and liabilities- | | |
| (Increase) in accounts receivable | (1,822,617) | (7,497,569) |
| (Increase) decrease in other assets | 337,639 | (337,639) |
| (Increase) decrease in ticket inventories | 268,394 | (207,928) |
| Increase (decrease) in accounts payable and other accrued liabilities | 1,073,533 | (1,871,949) |
| Increase in accrued prize liabilities | 4,637,104 | 8,818,613 |
| Net cash provided by operating activities | <u>2,343,580</u> | <u>5,151,053</u> |
| CASH FLOWS FROM INVESTING ACTIVITIES: | | |
| Additions to property and equipment | (1,819,640) | (1,877,915) |
| Proceeds from sale of assets | 196,700 | 108,600 |
| Net cash used for investment activities | <u>(1,622,940)</u> | <u>(1,769,315)</u> |
| CASH FLOWS FROM FINANCING ACTIVITIES: | | |
| Payments on capital lease obligations | (848,419) | (561,836) |
| Net cash used for financing activities | <u>(848,419)</u> | <u>(561,836)</u> |
| Net (decrease) increase in cash | (127,779) | 2,819,902 |
| CASH AND CASH EQUIVALENTS AT BEGINNING OF YEAR | 20,074,302 | 17,254,400 |
| CASH AND CASH EQUIVALENTS AT END OF YEAR | <u>\$ 19,946,523</u> | <u>\$ 20,074,302</u> |
| | ===== | ===== |

The accompanying notes are an integral part of these statements.

MISSOURI LOTTERY

GRAND PRIZE WINNERS TRUST ACCOUNT

BALANCE SHEETS AS OF JUNE 30, 1996 AND 1995

| | <u>1996</u> | <u>1995</u> |
|--------------------------------|------------------------|------------------------|
| <u>ASSETS</u> | | |
| INVESTMENTS | \$ 87,181,902 ===== | \$ 82,106,767 ===== |
| <u>LIABILITIES</u> | | |
| DEFERRED GRAND PRIZE LIABILITY | \$ 87,181,902 ===== | \$ 82,106,767 ===== |

MISSOURI LOTTERY

STATEMENTS OF CHANGES IN GRAND PRIZE WINNERS TRUST ACCOUNT

FOR THE YEARS ENDED JUNE 30, 1996 AND 1995

| | <u>1996</u> | <u>1995</u> |
|---------------------------------|-------------------------------|-------------------------------|
| TRANSFERS FROM MISSOURI LOTTERY | \$ 7,579,018 | \$ 14,734,329 |
| INTEREST ACCRETION | 6,136,117 | 5,078,142 |
| PAYMENTS TO GRAND PRIZE WINNERS | (8,640,000) | (7,154,000) |
| Net increase | <u>5,075,135</u> | <u>12,658,471</u> |
| BALANCE AT BEGINNING OF YEAR | <u>82,106,767</u> | <u>69,448,296</u> |
| BALANCE AT END OF YEAR | <u>\$ 87,181,902</u> ===== | <u>\$ 82,106,767</u> ===== |

The accompanying notes are an integral part of these statements.

MISSOURI LOTTERY

NOTES TO FINANCIAL STATEMENTS

JUNE 30, 1996 AND 1995

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES:

The Missouri Lottery (the Lottery) is accounted for as a proprietary type enterprise fund, is a component unit of the State of Missouri and is exempt from income taxes. The financial statements are prepared in accordance with generally accepted accounting principles on the accrual basis of accounting and conform with practices generally followed in the gaming industry.

Revenue Recognition

Sales of on-line lottery tickets are generated by the semiweekly "LOTTO" and "Powerball" games, and the daily "Show-Me 5" and "PICK 3" games. Sales of lottery tickets are made through licensed retail sales outlets via on-line terminals maintained by the retailers. Ticket sales are recognized at the time the player purchases a ticket from the retailer.

Sales of instant lottery tickets are made to licensed retail sales outlets with the right of return. Ticket sales are recognized upon the sale of tickets to licensed retailers and are valued at the sale price to the player. Allowances have been established for estimated tickets to be returned by retailers of approximately \$288,000 and \$270,000 at June 30, 1996 and 1995, respectively.

Sales of pull-tab lottery tickets are made to licensed retail sales outlets with no right of return. Ticket sales are recognized upon the sale of tickets to retailers and are valued at the sale price to the player.

Prizes

Expenditures for on-line lottery ticket prizes are recorded based on a minimum of 45% of on-line lottery ticket sales. The minimum grand prize amount for the semiweekly "LOTTO" game is \$1,000,000. Grand prize winners have the choice of receiving the prize in 20 annual installments or a portion of the prize in one lump-sum payment. Any prize that remains unclaimed for one year from the date of the on-line game drawing is used to fund future prize pools.

Expenditures for instant lottery ticket and pull-tab lottery ticket prizes are recorded based upon the unique, predetermined prize structure for each game and are accrued as tickets are sold to the retailer.

Cash and Cash Equivalents

Cash and cash equivalents consist of cash and money market funds on deposit with the State Treasurer and banks. The cash on deposit with the State Treasurer is pooled with other Missouri state funds and is fully secured by the depository institutions holding the funds. The Lottery considers all highly liquid investments with a maturity of three months or less when purchased to be cash equivalents.

Retailer Fees

Licensed retailers are charged a fee for the right to sell lottery tickets. Additionally, certain retailers pay an annual fee in lieu of obtaining an insurance bond. Such fees are maintained in a reserve fund to offset uncollectible accounts receivable from retailers. This reserve fund approximated \$561,000 and \$714,000 at June 30, 1996 and 1995, respectively, and is reflected as a reduction of accounts receivable on the accompanying balance sheets.

Ticket Inventories

Ticket inventories consist of instant and pull-tab tickets purchased by the Lottery for new games which have not been implemented. Inventories are carried at cost, using the specific identification method. Tickets are charged to cost of tickets sold upon implementation of the game.

Property and Equipment

Property and equipment are carried at cost, less accumulated depreciation. Depreciation is computed on the straight-line method over the estimated life of the related asset. When assets are retired or otherwise disposed, the cost and related accumulated depreciation are removed from the accounts, and any resulting gain or loss is recognized in income for the period.

Due to Lottery Proceeds Fund

All income before operating transfers of the Lottery, as described in the accompanying statements of revenues, expenditures and retained earnings, accrues to the benefit of the State of Missouri. Operating transfers are made to the Lottery Proceeds Fund, which shall be appropriated by the State solely for the institutions of elementary, secondary and higher education.

Operating transfers are made monthly and are based on estimated income before operating transfers. A portion of the liability to the Lottery Proceeds Fund, equal to the net book value of capital additions after September 1, 1988, is deferred and is not subject to current operating transfers.

Supplemental Cash Flow Information

Cash paid for interest was \$226 and \$62,429 in fiscal 1996 and 1995, respectively.

2. STATUTORY REQUIREMENTS:

Missouri statutes provide that a minimum of 45% of the money received from the sale of lottery tickets shall be allocated to prizes. The costs of operating the Lottery, including all commissions to retailers, promotional costs, and all other administrative expenditures, are appropriated by the General Assembly of the State of Missouri.

The Lottery receives certain services for no charge from other Missouri state government agencies. Legal and investigative services are provided by the Attorney General's office and the Missouri State Highway Patrol, respectively. The Office of Administration provides certain services to process expenditures and payroll for the Lottery.

3. ON-LINE TICKET SALES:

On-line ticket sales consist of the following:

| | <u>1996</u> | <u>1995</u> |
|-----------|-----------------------|-----------------------|
| Powerball | \$ 89,376,918 | \$ 106,848,256 |
| PICK 3 | 46,609,753 | 40,050,873 |
| LOTTO | 32,683,662 | 33,520,409 |
| Supercash | - | 4,613,234 |
| Show-Me 5 | 25,534,373 | 15,203,279 |
| | <u>\$ 194,204,706</u> | <u>\$ 200,236,051</u> |
| | ===== | ===== |

4. PROPERTY AND EQUIPMENT:

Property and equipment consists of the following:

| | <u>1996</u> | <u>1995</u> |
|---|---------------------|---------------------|
| Land | \$ 315,052 | \$ 184,512 |
| Building | 2,505,721 | 2,505,721 |
| Computers and related software | 3,896,649 | 3,242,066 |
| Equipment | 7,673,242 | 6,384,790 |
| Autos | 1,608,532 | 1,521,416 |
| Equipment related to capital leases | - | 1,721,576 |
| Other | 45,000 | 36,000 |
| | <u>16,044,196</u> | <u>15,596,081</u> |
| Less- Accumulated depreciation and amortization | <u>8,899,289</u> | <u>7,971,447</u> |
| | <u>\$ 7,144,907</u> | <u>\$ 7,624,634</u> |
| | ===== | ===== |

5. PENSION PLAN:

The Lottery participates with other state agencies in the Missouri State Employees' Retirement System (MOSERS) plan. The plan is a multiagency, defined benefit plan that covers substantially all of the Lottery's employees. The Lottery's contributions to the plan are set annually by MOSERS and, in fiscal 1996 and 1995, were approximately \$509,000 and \$409,000, respectively.

6. LEASES:

The Lottery's regional facilities are held under operating lease agreements with renewal options available for one to four additional one-year periods. Annual rent expense for these facilities totaled approximately \$178,000 in fiscal 1996 and 1995.

The Lottery leases ticket vending machines under operating lease agreements with options available for additional one-year periods. Annual lease expense for these machines totaled approximately \$697,000 and \$732,000 in fiscal 1996 and 1995, respectively.

Capital Lease Obligation

During 1995 and a portion of 1996, the Lottery leased instant ticket validation and computer equipment through capital leases. The capital leases were capitalized at interest rates between 6.77% and 7.75%. Amortization of the capitalized amounts was recorded to depreciation expense. All capital lease obligations were terminated in fiscal 1996.

7. CONTRACTUAL ARRANGEMENTS:

The Lottery maintains contractual arrangements with providers of goods and services critical to the Lottery's operations. Significant contracts include an agreement with the provider of the Lottery's on-line game computer systems and agreements with producers of the Lottery's instant and pull-tab games tickets, among others. The contracts generally run for one year, with one-year renewals available at the option of the Lottery. The contracts require the Lottery to compensate vendors for goods and services that meet stated quality standards.

The Lottery is a member of the Multi-State Lottery Association (MUSL) which consists of 21 state and district lotteries (member lotteries) and operates the on-line Powerball game. MUSL formerly operated the Missouri Megabucks and Lotto*America on-line games. Under separate agreements between MUSL and each lottery, the member lotteries sell tickets for the Powerball game and remit 50% of sales to prize winners or to MUSL for payment of prizes. Member lotteries also fund MUSL's operating expenses, based on allocations by MUSL.

Grand prize winners of MUSL's Powerball, Missouri Megabucks and Lotto*America games receive prize payments annually over a 20-year period. Investment securities, with maturities that approximate all grand prize winner payments due to winners of MUSL games, are maintained by MUSL. The investments and related prize liabilities for winners of these games from the state of Missouri are excluded from the accompanying grand prize winners trust account statements. Future grand prize winner payments of MUSL games due to winners in Missouri are approximately \$289,536,000 as of June 30, 1996.

The Lottery has contributed to a prize reserve fund and set prize reserve fund, separately maintained by MUSL, to protect MUSL members in case of unforeseen liabilities and to pay certain prizes associated with Powerball, respectively. With certain restrictions, these fund balances are refundable to member lotteries upon termination of the member's agreement with MUSL or upon the disbanding of MUSL. At June 30, 1996, the Lottery's portion of the prize reserve fund and set prize reserve fund was approximately \$2,277,000 and \$1,780,000, respectively.

The Lottery has contributed to an account with MUSL which is used to pay certain operating expenses incurred by member lotteries for the Powerball game. With certain restrictions, the balances in this account are refundable to the member lotteries upon termination of the member's agreement with MUSL or upon the disbanding of MUSL. At June 30, 1996, the Lottery's portion of the balance in this account was approximately \$430,000.

8. GRAND PRIZE WINNERS TRUST ACCOUNT:

Since March 1990, to fund future payments under grand prize winner prize claims, the Lottery purchases U.S. Treasury zero coupon bonds, with maturities approximating deferred grand prize annuity installment amounts and due dates. The securities purchased are held in the Lottery's name in safekeeping by the Federal Reserve Bank in a separate account for the grand prize winners trust account. The investments in these securities are carried at cost, adjusted for the accretion of discounts based on the purchase yield and the maturity date. Accretion on these investments is not recognized as revenue of the Lottery but is credited to deferred grand prize liability. These securities are not subject to trading and are intended to be held to maturity. The market value of these securities at June 30, 1996 and 1995, was approximately \$91,477,000 and \$88,899,000, respectively. The maturity value of securities held at June 30, 1996 and 1995, was \$147,934,000 and \$143,366,000, respectively.

Scheduled grand prize installment payments to be funded by the maturing U.S. Treasury zero coupon bonds, as of June 30, 1996, are as follows:

| <u>Fiscal Year Ending</u> | <u>Amount</u> |
|--------------------------------|----------------------|
| June 30, 1997 | \$ 9,372,000 |
| June 30, 1998 | 9,372,000 |
| June 30, 1999 | 9,372,000 |
| June 30, 2000 | 9,372,000 |
| June 30, 2001 | 9,372,000 |
| Thereafter | 101,074,000 |
| Total installment payments due | 147,934,000 |
| Less- Interest portion | 60,752,098 |
| | <u>\$ 87,181,902</u> |
| | ===== |

Prior to March 1990, the Lottery purchased annuity contracts from selected insurance companies to fund "LOTTO" grand prize claims. Because it is the intent of the Lottery that the insurance companies make future installment payments directly to each prize winner, neither the value of the annuities nor the value of the related future payments are reflected in the accompanying financial statements. Future installment payments to be made to grand prize winners by these insurance companies totaled approximately \$77,532,000 at June 30, 1996.